

## TEST YOURSELF ON THE ACCOUNTING CYCLE

### True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- T    F    1.    If all transactions were originally recorded in conformity with generally accepted accounting principles, there would be no need for adjusting entries at the end of the period.
- T    F    2.    Adjusting entries contribute to accurate financial reporting by allocating revenues to the period in which they were earned and expenses to the period in which they were incurred.
- T    F    3.    Every adjusting entry must change both an income statement account and a balance sheet account.
- T    F    4.    An account called Unearned Commissions Revenue is a revenue account.

- T F 5. Accrued revenue is a term used to describe revenue which has been received but not yet earned.
- T F 6. The adjusting entry to allocate part of the cost of a one-year fire insurance policy to expense will cause total assets to increase.
- T F 7. The adjusting entry to recognize that commission revenue not previously recorded (or billed to a customer) has now been earned will cause total assets to increase.
- T F 8. The adjusting entry to recognize an expense which has not yet been recorded and will not be paid until some future period will cause total assets to decrease.
- T F 9. The adjusting entry to recognize that a fee received in advance from a customer has now been earned will cause total liabilities to increase.
- T F 10. If employees have worked eight days in a period for which they will not be paid until the first payday next period, and if no adjusting entry is made at the end of this period, total liabilities will be understated and both net income and owners' equity will be overstated.
- T F 11. The original cost of a building minus the accumulated depreciation is called the *book value*, or *carrying value*.
- T F 12. The concept of *materiality* allows accountants to ignore transactions involving small dollar amounts.
- T F 13. The dollar amounts appearing in financial statements can be taken directly from an adjusted trial balance prepared at year end.
- T F 14. Adjusting entries are the tools by which accountants apply the realization and matching principles.
- T F 15. The concept of materiality may allow accountants to ignore certain accounting principles.

### Completion Statements

Fill in the necessary word to complete the following statements:

- The four types of transactions requiring adjusting entries are \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ transactions.
- An adjusting entry at November 30 concerning the cost of an insurance policy serves two purposes: (a) it \_\_\_\_\_ the proper amount of \_\_\_\_\_ to November operations, and (b) it reduces the \_\_\_\_\_ account entitled \_\_\_\_\_ so that the correct amount will appear in the November 30 balance sheet.
- Adjusting entries always recognize either a \_\_\_\_\_ or an \_\_\_\_\_.

4. The adjusting entry to record receiving some of the benefits in the current period from an expenditure made in an earlier period consists of a \_\_\_\_\_ to an \_\_\_\_\_ account and a \_\_\_\_\_ to an \_\_\_\_\_ account.
5. If a customer pays in advance for services to be rendered, the entry to record the receipt of the payment consists of a \_\_\_\_\_ to an \_\_\_\_\_ account and a \_\_\_\_\_ to a \_\_\_\_\_ account.
6. If an expense has been accumulating from day to day (such as wages) without being recorded, the proper adjusting entry would \_\_\_\_\_ an \_\_\_\_\_ account and \_\_\_\_\_ a \_\_\_\_\_ account.
7. If an expenditure will yield benefits to a business only during the period in which it is made, the entry for the expenditure consists of a \_\_\_\_\_ to an \_\_\_\_\_ account and a \_\_\_\_\_ to an \_\_\_\_\_ account and/or a \_\_\_\_\_ account.
8. If an expenditure will yield benefits to the business over several periods, the entry for the expenditure consists of a \_\_\_\_\_ to an \_\_\_\_\_ account and a credit to an \_\_\_\_\_ account and/or a \_\_\_\_\_ account.
9. The South Bay Management Company agreed to manage an apartment building beginning May 15, 20\_\_, for one year at a management fee of \$400 per month. The first \$400 payment is received June 15, 20\_\_. The adjusting entry at May 31, 20\_\_ should consist of a debit to \_\_\_\_\_ and a credit to \_\_\_\_\_. When the first payment is received on June 15, the collection should be recorded by an entry debiting \_\_\_\_\_ for \$400, and crediting \_\_\_\_\_ for \$\_\_\_\_\_ and \_\_\_\_\_ for \$\_\_\_\_\_.
10. Adjusting entries are the tools by which accountants apply the \_\_\_\_\_ and \_\_\_\_\_ principles.
11. The concept of \_\_\_\_\_ allows accountants to use estimated amounts if their estimates have no material effects on the financial statements.

## Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

- \_\_\_ 1. The *accounting period* of a business may best be described as:
  - a. One month.
  - b. One year.
  - c. The time span covered by the balance sheet.
  - d. The time span covered by the income statement.
  
- \_\_\_ 2. The purpose of *adjusting entries* is to:
  - a. Correct errors made in the accounting records.
  - b. Update the balance of the Retained Earnings account for changes in owners' equity temporarily recorded in revenue and expense accounts.
  - c. Prepare the revenue and expense accounts for recording the transactions of the next accounting period.
  - d. Allocate revenue and expenses among accounting periods when the related business transactions affect more than one period.
  
- \_\_\_ 3. The entry recording the liability to employees for work done during the period for which they have not yet been paid is an example of which type of adjusting entry?
  - a. Converting an asset to expense.
  - b. Converting a liability to revenue.
  - c. Accruing unpaid expenses.
  - d. Accruing uncollected revenue.
  
- \_\_\_ 4. A balance sheet account was debited in the amount of \$1,240 for office supplies purchased during the first year of operations. At year-end, the office supplies on hand were counted and determined to represent a cost of \$360. The appropriate adjusting entry would:
  - a. Have no effect on net income.
  - b. Consist of a debit to expense of \$360 and a credit to the balance sheet account.
  - c. Decrease assets by \$1,240.
  - d. Increase expenses \$880.
  
- \_\_\_ 5. Failure to make an adjusting entry to recognize accrued interest receivable would cause:
  - a. An understatement of assets, net income, and owners' equity.
  - b. An understatement of liabilities and an overstatement of net income and owners' equity.
  - c. An overstatement of assets, net income, and owners' equity.
  - d. No effect on assets, liabilities, net income, and owners' equity.

- \_\_\_ 6. Assets would be overstated if a necessary adjusting entry were omitted for:
- a. Expired insurance.
  - b. Accrued salaries.
  - c. Accrued interest earned.
  - d. Revenue collected in advance during the period.
- \_\_\_ 7. Which of the following adjusting entries will result in a decrease in assets and owners' equity?
- a. The entry to record the earned portion of rent received in advance.
  - b. The entry to record accrued wages payable.
  - c. The entry to record revenue earned but not yet received.
  - d. None of the above.
- \_\_\_ 8. Which of the following statements concerning materiality is **not** valid?
- a. Generally accepted accounting principles do not provide clear-cut guidelines as to what is considered "material" in each situation.
  - b. The concept of materiality may result in financial statements that are not completely precise.
  - c. Strict adherence to the matching principle or the realization principle is not required for items considered "immaterial."
  - d. The concept of materiality results in financial statements that are less useful to decision makers because many important details have been omitted or estimated.
- \_\_\_ 9. The adjusted trial balance reports all of the balances in the general ledger:
- a. After the end-of-period adjusting entries have been made and posted.
  - b. Before the end-of-period adjusting entries have been made and posted.
  - c. After the end-of-posting period adjusting entries have been made but before they are posted.
  - d. None of the above.

## Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

*Accrued revenue*  
*Unearned revenue*  
*Accrued expense*  
*Adjusting entries*

*Realization principle*  
*Matching principle*  
*Materiality*  
*Adjusted trial balance*

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- a. An asset that becomes an expense as resources are consumed to generate revenue.  
\_\_\_\_\_
- b. The accounting principle governing the timing of revenue recognition.  
\_\_\_\_\_
- c. The accounting principle of off-setting revenue with expenses incurred in producing that revenue.  
\_\_\_\_\_
- d. The relative importance of an item or an amount as it relates to the interpretation of financial statements.  
\_\_\_\_\_
- e. An expense that has been incurred, but not yet paid.  
\_\_\_\_\_
- f. A liability often settled by rendering services or by delivering goods to customers.  
\_\_\_\_\_
- g. Revenue earned, but not yet collected.  
\_\_\_\_\_

2. Commuter Airlines prepares monthly financial statements. On August 31, the company's accountant made adjusting entries to record:
- Depreciation for the month of August.
  - Earning ticket revenue which had been collected in advance. (When passengers buy tickets in advance, Commuter Airlines credits an account entitled Unearned Ticket Revenue.)
  - The portion of the company's prepaid insurance policies which had expired in August.
  - Salaries payable to employees which have accrued since the last payday in August.
  - Interest revenue which had accrued on an investment in government bonds.

Indicate the effect of each of these adjusting entries upon the major elements of the company's financial statements—that is, upon revenue, expenses, net income, assets, liabilities, and owners' equity. Organize your answer in tabular form, using the column headings provided and the symbols + for increase, – for decrease, and NE for no effect. The answer for adjusting entry **a** is provided as an example.

Adjusting entry	Income Statement				Balance Sheet			
	Revenue	–	Expenses	=	Net Income	Assets	=	Liabilities + Owners' Equity
a	NE		+		–	–		NE
b								
c								
d								
e								

3. The following information pertains to the accounting records of Winslow Corporation on December 31, *prior to* making monthly adjusting entries.
- Winslow's trial balance reports unexpired insurance of \$400. Of this amount, only \$340 remains unexpired at December 31.
  - Winslow's trial balance reports office supplies of \$1,000. A physical count revealed only \$350 of supplies on hand at December 31.
  - Depreciation expense on office equipment for the month ended December 31 amounts to \$210.
  - Winslow borrowed money on December 1 of the current period by issuing a \$5,000, 12%, note payable. One full month of unpaid and unrecorded interest has been accrued for period ending December 31.
  - Winslow's trial balance reports unearned commissions of \$2,800. Of this amount, only \$2,000 remains unearned at December 31.
  - One week of unpaid and unrecorded salary expense has accrued for the month ending December 31. The amount accrued totals \$2,100.

Record the company's necessary adjusting entries in the space provided below:

[illegible]